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DOT SALE OF CONRAIL

HEARING

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

THE SALE OF CONRAIL BY THE DEPARTMENT OF TRANSPORTATION

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DOT SALE OF CONRAIL

WEDNESDAY, JUNE 20, 1984

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room SR-253, Russell Senate Office Building, Hon. John Danforth (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Pamela Garvie, professional staff member, and Linda Morgan, minority staff counsel.

OPENING STATEMENT BY SENATOR DANFORTH

Senator DANFORTH. Just the day before yesterday, the deadline was reached for receiving bids for the sale of Conrail. I can remember back in 1981 when then Secretary of Transportation Drew Lewis hosted a breakfast in his office for various members of the Senate and House, and described to us his proposal to sell Conrail.

My own feeling was one of admiration for Secretary Lewis and considerable doubt that anybody would be bidding on Conrail, at least under the then existing circumstances.

Now it turns out that no fewer than 14 bids have been received. The press has indicated 13, but Jim Burnley just told me that a 14th bid was lost in the mail and did arrive at DOT. I believe the 14 bids are testimony to the wisdom of the concept of the sale, to the success of the management of Conrail, and to the professional manner in which the Department of Transportation has handled the sale.

Obviously, it is premature, less than 48 hours after the deadline, to have any detailed description as to precisely what the Department intends to do. So this hearing is very general. It is simply for the purpose of giving the Surface Transportation Subcommittee a view of where we stand now and where we are going, and a view of the relative criteria for determining where we go from here.

My own view—and I have stated this repeatedly, both in this committee and in private to the Secretary and to you, Jim, and to John Riley and anyone else who cares to hear—that to me, clearly the prime consideration is not how many dollars come in; when we have got $200 billion deficits, what is another few hundred million? The prime consideration is, what is going to be the future of Conrail and what sort of arrangement offers the best assurance that the system will be surviving not just for a year or two, but on into the future.

I think the best way to proceed, after Senator Lautenberg makes any statement which he cares to make, would be for all three witnesses on the list today to testify one after another, and then be questioned as a panel.

The three witnesses are the Honorable James H. Burnley, Deputy Secretary, Department of Transportation; Mr. Kenneth Brody, partner in Goldman, Sachs & Co.; and John Wells, vice president and staff director, United States Railway Association.

I might say that it is the plan of the subcommittee to hold an additional hearing after the decision is made by the Department.

Frank.

OPENING STATEMENT BY SENATOR LAUTENBERG

Senator LAUTENBERG. Thank you, Mr. Chairman, on two counts. One is that I commend you for holding this hearing into the sale of Conrail, and the other is for reestablishing the fact that the clock, as we know it, is still something that is reliable and you, Mr. Chairman, are one of those who adhere to prompt starts and surprise me, frankly.

Senator DANFORTH. Sometimes.

Senator LAUTENBERG. I think it is great, and I am sorry that I was a few minutes late.

Few issues could be of more economic consequence to the Northwest and Midwest than the fate of this railroad. Earlier this year, I sponsored a resolution in the Senate calling for these hearings. That resolution had the support of senators from throughout the Northeast and the Midwest, and I want to thank, in addition to the chairman, Senator Riegle with whom I have worked very closely on this matter.

This hearing was scheduled today so that this committee would have timely input into the Department of Transportation process for the sale, including its consultation with Congress. The hearing, I hope, will also elicit information on the bids received by DOT, the bidding deadline having closed Monday night.

In addition, we will be exploring the current health of this railroad. Part of the transaction here, obviously, is to make sure that we are selling what we represent and that the new buyer, whoever that is, has a chance to continue the operation of this railroad and that we, in fact, get a reasonable price for it, though that is not the most critical issue.

I firmly believe that it is, as I said, of critical importance to the Northeast and my State of New Jersey, that if it is sold this year, it be sold, yes, at the right price, to the right party, and at the right time. And this Senator is in no hurry to sell Conrail, though I do want it sold, and certainly will not stand in the way of the right sale.

I look forward to the testimony. I would like to add, Mr. Chairman, my appreciation to the Federal Railroad administrator, John Riley, for his timely and candid briefings on this matter to both me and my staff. He has been professional, very helpful; we appreciate it.

In addition, the committee staff on both sides here have helped considerably in our dealing with this important and complicated matter. I thank them and thank you, Mr. Chairman.

Senator Hollings has an opening statement for the record.

[The statement follows:]

OPENING STATEMENT BY SENATOR HOLLINGS

Today the Committee is examining clearly one of the most important transportation issues now before Congress—the future of Conrail. As we all know, Conrail is critical to the economy and transportation needs of the Northeast region, as well as the rest of the country. Thus Congress and the Federal Government have important responsibilities in ensuring that the future of the Conrail system is secure.

The issue before us today is the sale of Conrail in the private sector, which Congress mandated in the Northeast Rail Services Act of 1981, charging the Department of Transportation (DOT) with the responsibility for finding potential buyers. While that act mandates a sale, we must be sure that several interests are carefully considered before a sale proposal is implemented.

We must protect the taxpayer by securing a reasonable return on the Federal investment in Conrail. Also, we must ensure the maintenance of a rail system in the Northeast that is strong, maintains competitive rail service, and meets the transportation needs of that region. This means that we must find a buyer that is financially sound and brings additional capital and other funds to the Conrail system without encumbering the railroad, and is committed to rail service and will not undermine the financial and operational improvements that Conrail has made in recent years. Finally, we must recognize the significant contributions that rail labor has made to ensure improvement in Conrail, and the importance of labor participation in shaping the future of the railroad.

Congress must be assured that any sale of Conrail responds to those interests, which I know I share with my colleagues on the Committee. This hearing today will provide an important forum for Committee members to express specific concerns and to examine how DOT intends to assess those interests in choosing a potential purchaser. In addition, I look forward to further hearings to focus more closely on individual offers and the specifics of any sale proposal.

Much attention has been paid to the sale of Conrail, but there is still more work to be done to ensure that the integrity of the existing Conrail system and service is maintained. I would hope that the Administration maintains close and open contact with Congress and affected parties as we progress through this process, which will have such a profound impact on the Northeast and the rest of the Nation.

Senator DANFORTH. Mr. Secretary.

STATEMENTS OF JAMES H. BURNLEY IV, DEPUTY SECRETARY, DEPARTMENT OF TRANSPORTATION; KENNETH D. BRODY, PARTNER, GOLDMAN, SACHS & CO., NEW YORK, NY; AND JOHN WELLS, VICE PRESIDENT AND STAFF DIRECTOR, UNITED STATES RAILWAY ASSOCIATION

Mr. BURNLEY. Mr. Chairman and Senator Lautenberg, I appreciate this opportunity to appear before you today to discuss the Secretary's ongoing efforts to sell our interest, the Government's interest, in Conrail while assuring continued service to shippers in the Northeast, getting the best possible return to the Federal Government for its investment over the past decade, and at all times keeping in mind the need for proper recognition of the contributions that have been made by both Conrail's organized and nonorganized employees, its managerial employees.

I am convinced that we will succeed in reaching each of these goals. It was the work of this committee and the House Commerce Committee 3 years ago, in developing the Northeast Rail Service Act of 1981, that will make this largely possible.

As you both have noted, our deadline for submission of offers to purchase Conrail was reached Monday of this week, and I am

pleased to announce that we have received 14 offers for consideration. The Department of Transportation staff, as well as Goldman, Sachs & Co., represented today by Ken Brody who is sitting to my right, our investment advisers, are now digesting the details of these offers. I have copies of these offers with me, which I would like to make available to the committee.[1]

Once we have finished our analysis, we will confer with the leadership of both houses, both majority and minority, before any decision is made. And following those consultations, Secretary Dole will recommend to the Congress the offer most consistent with the public interest.

The Secretary is taking this approach because she believes that the public interest, as well as the plain intent of NERSA, require us to develop the broadest possible range of options before reaching a decision. The efforts to locate additional prospective purchasers did not, however, imply any dissatisfaction with the early bidders.

The 1981 NERSA Amendments to the 3R Act, the Regional Rail Reorganization Act, provided for submission to Congress of a plan recommended by the Secretary for the sale of the Government's common stock holdings in Conrail. To satisfy the statutory criteria, the recommended plan must—quoting from NERSA: "Ensure continued rail service, promote a competitive bidding" process for purchase of the stock, and maximize the return to the United States on its investment."

The Secretary and I believe we have well satisfied the competitive bidding criterion on by generating the 14 offers that we now have under review. We plan to judge the merits of each of these proposals as follows: First, we will favor the purchase option that leaves the railroad in the strongest financial condition after the sale. The reason is obvious. Conrail needs the financial strength to provide competitive services over the long term, regardless of national or regional economic cycles.

To say the same thing another way, we believe that NERSA requires us to pursue the option that minimizes the risk that the Federal Government will ever be asked again to assume responsibility for Conrail.

To accomplish this will require analysis of elements such as the financial condition of the offeror and financial projections for the combined entity after consummation of sale. Availability of financing to make the purchase, and the ability to service any resulting debt will also be reviewed as to each offeror.

We will also carefully scrutinize such factors as commitments made by each of the offerors to maintain a minimum working capital level at Conrail and also their specific plans for reinvestment in Conrail.

Second, protection of service to shippers and communities in the Northeast is one of our major concerns. In this area we will be looking at such elements as any reduction or enhancement of competitive service, including service commitments to the present Conrail system, and operational plans for a combined entity if purchase is made by another railroad or its holding company.

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[1] The offers have been retained in the committee files.

Specific areas of interest here would be abandonment of lines, consolidation of yards and facilities, the impact on essential service, and the impact on Conrail's labor force.

Third, we will favor the option that is consistent with the previous two criteria and offers a maximum return to the United States. The Secretary would not favor the plan with the highest rate of return to the Government if it were seriously at odds with the public interest criteria I have outlined.

In this area, our analysis will focus on the form and amount of consideration and the treatment of tax issues. For example, we will be looking at treatment of Conrail's NOL's, or net operating losses, and its ITC's, or investment tax credits. We believe core legislation will most likely be needed to allow a sale plan to go forward, and we hope to transmit such core legislation to the Congress in the very near future.

I want to stress the word "core," because a purchaser may believe its offer requires additional statutory provisions tailored to the terms of its own offer. Legislation may also be needed to address technical changes that we need to allow consideration of an appropriate range of reasonable offers to purchase stock in Conrail. Obvious examples would be the elimination of the Government's right to elect Conrail's directors, or those provisions relating to the United States Railway Association's rights under debt and preferred stock indentures after these instruments are canceled.

The most significant objectives of such legislation in our judgment would be to assure that needed legislative changes are made at the same time Congress reviews a particular sale plan; also, that Conrail should be treated like any other railroad after the sale. The Goverment's investment in Conrail should be fully terminated to assure that the United States does not reinherit Conrail in the future, as I mentioned a moment ago, and the authority and jurisdiction of the special court and USRA should be undisturbed with regard to the continuing valuation litigation and other USRA functions that outlive the sale.

We will be considering what additional legislation, if any, may be required as we evaluate the sale offer.

We will provide Congress with this core legislation, a comparison of the various offers, and our recommended plan as soon as possible. We feel an obligation to do everything we can to resolve the uncertainties now facing shippers, employees, and communities being served by the Conrail system. No one is well-served by an indefinite period of suspense about who will ultimately own Conrail.

For example, the States in the region Conrail serves are losing over $20 million per year in taxes because of Federal ownership of the railroad. Conversely, however, we have no intention of rushing toward a sale if it does not meet the public interest criteria we have defined.

Secretary Dole has had ample opportunity to contrive a quick solution, and she has declined to do so. Her desire is to execute the sale that best protects the public interest, and we look forward to working with the committee to achieve that objective.

This completes my prepared statement and, Mr. Chairman, I will be happy to answer questions after the other two witnesses have given their statements.

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Senator DANFORTH. Thank you, Mr. Secretary.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS THERETO

Question. With any sale of Conrail, there is an obvious concern about the maintenance of existing rail service levels in the Northeast region and about the commitment of a potential purchaser to Conrail and the rail sevice that it provides. How will DOT assess such a commitment? How will you evaluate an offeror's intentions in wanting to purchase Conrail? Where the offeror is another corporate entity, to what extent will the past history of that entity be relevant in such an analysis?

Answer. The maintenance of rail service by the post-sale conrail is a major concern of the Secretary. One of her three primary criteria for evaluating the offers is to look at the extent to which Conrail will be able to provide service to its customers and the states which it presently serves.

Our assessment of this criterion is being performed by reviewing the specific provisions of the offers, as well as in negotiations with each of the offerors. Furthermore, although we generally believe that the post-sale Conrail should be treated as much like other railroads as possible, we expect the eventual purchase agreement to contain service covenants.

The intentions of the various offerors have been elicited during discussions and negotiations that both we and Goldman Sachs, our investment advisor, have held with the offerors. The purchase agreement will contain a variety of strong protective provisions keyed to maintaining Conrail's financial strength and service capacity.

Question. You have indicated that the capital commitment made by an offeror is relevant in assessing the financial strength of the Conrail entity after the sale, and also in evaluating the commitment of a purchaser to continue rail sevice. How do you intend to arrive at an acceptable level of capital commitment?

Answer. A general approximation of an acceptable level of capital commitment can be arrived at by reviewing Conrail's capital expenditures to date. Our assessment will draw on these figures.

Question. Another factor which you have indicated will be evaluated in assessing each of the offers is the source of funding for the purchase price and other future expenses. To what extent are you requiring specifics on the funding sources? In this respect, how are you evaluating the public offering portion of any offer?

Answer. Goldman Sachs is closely analyzing the specific source of funding for each of the offers. As a general rule we would prefer as much equity as possible. This is because the ultimate test in evaluating a funding source is the impact that it will have on Conrail's balance sheet. As to the public offering portion of any offer, we are assessing the extent to which the offeror has analyzed the market for Conrail's stock, whether the offeror has a commitment from an underwriter, and the extent to which the offeror has considered the many issues that arise in a public offering.

Question. There is continued concern about the impact of any sale on the maintenance of competitive rail service in the Northeast region. To what extent will DOT do market analyses of affected communities, particularly where a potential purchaser is another rail entity? Will DOT consider in a final deal conditions to protect rail competition? Will the Department of Justice be asked to submit a formal analysis of the competitive aspects of particular offers?

Answer. The competitive aspects of any sale are obviously of concern to us, particularly if the purchaser is another railroad or owns another railroad. The DOT staff presently has such analyses under way, focusing on potential traffic diversions and competitive effects so as to determine the extent to which any particular community might be adversely affected. With regard to protection of rail competition, we would certainly consider conditions protecting such competition where our analysis indicates that to be appropriate. With regard to the Department of Justice, we anticipate that it will be invited to comment if the purchaser is a competing railroad.

Question. You indicate that you have had contact with the United States Railway Association (USRA) regarding the sale of Conrail. To date, what form has this contact taken? How would you anticipate using USRA as you proceed with your evaluation of the bids?

Answer. The Department's contact with USRA is at the highest level in view of the Secretary's membership on the USRA Board. Both Secretary Dole and I confer frequently with USRA Chairman Stephen Berger. The staffs of the agencies are also

in regular contact through the exchange of information on their analysis of Conrail. In this regard, DOT has provided computer software and supporting data to permit USRA to conduct rail network analyses, and USRA has provided us with computer tapes containing Conrail traffic data. We do not anticipate asking USRA to perform a formal evaluation of any offer for Conrail since we are in close contact with USRA's leadership and its staff.

Question. Questions have been raised about the future of Conrail's existing management once Conrail is sold in the private sector. Should the retention of Conrail management be a consideration in any sale proposal?

Answer. One of the significant reasons for Conrail's recent successes has been its management team. We have therefore encouraged all the bidders to meet with Conrail management.

Question. There has been much discussion about the financial projections for Conrail over the next several years. What is DOT's assessment of Conrail's financial future?

Answer. We believe that Conrail has the capacity to operate profitably over the long term.

QUESTIONS OF SENATOR LONG AND THE ANSWERS THERETO

Question. In your prepared testimony on page 3, you stated that the Department of Transportation "will favor the purchase option that leaves the railroad in the strongest financial condition after the sale." What time frame is envisioned in your reference to "after the sale?" Does the Department mean the strongest financial condition 2 months, 2 years, or 20 years after the sale? Would not the Northeast Rail Service Act (NERSA) require careful consideration of the long-term financial condition and strength of Conrail in order to ensure continued rail service?

Answer. We have not put a particular time frame on the definition of "after the sale." When looking at Conrail's financial strength, we would like to assure that it is strong as far into the future as possible. However, reliable long-term projections are extremely difficult at best. The primary area that we will be reviewing to assure that post-sale Conrail is in a strong financial condition is its projected debt burden and related expenses that might interfere with its ability to survive over the long term.

Question. In your prepared testimony on page 4, you stated that the Department of Transportation will favor the option that is consistent with public interest criteria and "offers the maximum return to the United States." To what extent should non-financial returns be considered, such as the value of the Conrail sale as a model for other railroads, industries, and nations?

Answer. The specific criterion of maximizing the return to the United States is set forth in Section 401(a)(2)(C) of the Regional Railroad Reorganization Act of 1973, as amended by the Northeast Rail Service Act of 1981. Although the Conrail sale may provide a model for other railroads, industries, and nations, we do not believe that Section 401(a)(2)(C) contemplates such when it speaks of maximizing "the return to the United States on its investment." Rather, we believe that the language of the statute specifically refers to the financial return.

Question. Deputy Secretary Burnley, you indicated at the hearing that without the cooperation of labor in giving more productivity and getting more done with a smaller number of people, Conrail would not now be a profit-making operation. Given that fact, should we not allow the employees who make such sacrifices and contributions the long-term opportunity to share in the profitability and success of Conrail? Should we not encourage similar employee participation in all industries, railroads in particular?

Answer. The role of the employees in making Conrail the profitable corporation that it is today is recognized by all who are familiar with the Conrail situation. This is a major reason that we have maintained a regular contact with the Railway Labor Executives' Association (RLEA) while analyzing the various offers for Conrail. We believe it most appropriate for the employees to share in the profitability and success of Conrail. In all likelihood, whichever plan the Secretary submits to the Congress for approval will contain such provisions. The outcome of our efforts to sell Conrail may well present a model for employee participation in all industries, including railroads, but we are not attempting to establish any general policy in this area.

Question. Do you see a role for increased employee ownership of Conrail? To what extent do the various offers received contemplate such a role?

Answer. As you know, Conrail employees today are the beneficiaries of an employee stock option plan representing 15 percent of the common stock of Conrail. A role for increased employee ownership of Conrail may exist, and some of the offers provide for such an increase. With regard to what the various offers contemplate, I have listed below in summary form the extent of employee ownership proposed in each original, written offer. It should be kept in mind, however, that during the negotiations with the various offerors, these proposals are in some instances being changed.

Offeror:	Employee ownership:
Alleghany	0 percent after buy-out of ESOP; participation in a profit-sharing program; two union seats on Board of Directors.
Allen & Company	5 percent of outstanding common stock to employees; union representation on Board of Directors; continuation of present ESOP.
CSX	Projected agreement with rail labor to arrive at settlement of interest in current ESOP.
Citicorp	Two options, with varying amounts of Conrail common stock going to the employees.
Consolidated American Transportation.	Not addressed in offer.
First Allied	Employees to receive 7 percent of preferred stock; two representatives on Board of Directors; participate in a profit-sharing plan.
Guilford Transportation Industries	Amend ESOP to provide for ownership of 30 percent of common stock plus $300 million par value 12 percent cumulative preferred stock.
Imperatore	3 million shares of new capital stock in exchange for stock in present ESOP.
Marriott	30 percent of common stock; $300 million of preferred stock; 3 seats on the Board of Directors; bonus program for 15 years funded by 5 percent of Conrail net income in excess of $450 million; elimination of present ESOP.
McCulloch	Not addressed in offer.
Mercury Rail	Continue present ESOP.
Norfolk Southern	$325 million in cash or Norfolk Southern stock; elimination of current ESOP.
Perryman	Not addressed in offer.
RLEA	Establish new ESOP; short-term incentives to all current employees; 3 labor representatives on Board of Directors.
Tippecanoe	25 percent of common stock to employees.

Question. I understand that the Chicago and North Western has had continued success with employee ownership. Do you think that significant employee ownership would contribute to the long range viability of Conrail?

Answer. It is true that the Chicago and North Western has had success with employee ownership, although it is also true that management level employees, far more than contract employees, today own the controlling interest in the C&NW. Apparently the contract employees have, over the last several years, largely liquidated their holdings of C&NW stock. With regard to whether significant employee ownership would contribute to the long-range viability of Conrail, we have no reason to believe that it would not, and a.e considering this issue during our review of the several offers that provide for such ownership.

QUESTIONS OF SENATOR RIEGLE AND THE ANSWERS THERETO

Question. What weight will be given to competitive factors relating to the purchase of Conrail by an operating railroad? Will the preservation of competition be the most significant in your decision-making process?

Answer. The effect on shippers and the public, particularly where the offeror is a railroad or owns a railroad, is a very important consideration in our analysis of the offers. Our three primary criteria are to assure that Conrail is in a strong financial condition following the sale, that service to shippers and states will survive over the long term, and that the return to the United States on its investment is maximized. In this context, we view Conrail's business condition and service preservation as intimately related. The competitive aspects of any sale are of concern to us, particularly if the purchaser is another railroad or owns another railroad. Our staff presently has such analyses under way, focusing on potential traffic diversions and anti-competitive effects.

Question. What other elements are contained in the "public interest" criteria that must be met by any successful bidder? Is one element the continuation of existing service patterns by Conrail or the new owner?

Answer. As mentioned above, the three primary criteria include an analysis of whether Conrail will be able to maintain service to the States and shippers in the Northeast region of the country. The long-term continuation of such service is extremely important to us.

Question. How will you be able to ensure that the new owner will not at some future date partition Conrail assets and sell those assets in a piecemeal fashion? If such guarantees cannot be provided, isn't this contrary to your desire to maintain Conrail as whole entity?

Answer. We envision that any sale agreement will contain language limiting the ability of the purchaser to partition Conrail. It is not our intention to permit the railroad to be broken up shortly after the sale.

Question. Will the evaluation procedures reflect any different criteria in determining Conrail's acquisition by an operating rail carrier versus acquisition by a non-rail investment entity?

Answer. Our analysis of the offers from railroads necessarily includes some factors that are not of major concern for a non-rail purchaser. Most particularly this relates to the area of competition, and the extent to which particular rail purchasers would have an adverse effect on competition.

Question. Will Conrail's existing debt be forgiven in whole or in part as an element of the sale? If so, will such forgiveness be available in other rail acquisitions situations that are pending?

Answer. We believe that it is in the best interest of the United States to remove the government from all ownership of Conrail. Accordingly, we believe that the present debt and preferred stock held by the government should be eliminated effective upon the sale of the common stock. Not only will this be important in assuring that the post-sale Conrail is financially secure, but it also will create more of an incentive for future equity investment in the company.

Two other rail acquisitions are presently pending. The Alaska Railroad Transfer Act controls the disposition of the Alaska Railroad and specifically provides for purchase payment by the State of Alaska to the Federal Government. There is no debt to be forgiven in that transaction. The Milwaukee Railroad Restructuring Act provides for the cancellation of $99 million of debt owed to the Federal Government by the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

Question. Will parties that are affected by the decision to sell Conrail, but not directly involved in the negotiations, be able to comment and register their views on the alternatives facing the Department? If so, what format will this comment period adopt?

Answer. The Department has been in frequent and continuing contact with states, shippers, and other interest groups to keep them informed of the status of our Conrail sales effort and we have encouraged prospective bidders to meet with each of these groups separately from our meetings. The offers we have received reflect the degree to which bidders have sought out and responded to the public's concerns and to the concerns of interest groups.

A second opportunity for interested parties to express their view is occurring now that offers have been received. We are in continuing contact with interested parties, including Congressional leaders, State and labor representatives, and shippers, as we proceed with the selection of an offer to submit to the Congress. Hundreds of

those parties have also expressed their views in writing in recent weeks, and we are considering and responding to these letters.

A third opportunity for interested parties to express their views will occur when the Congress holds public hearings addressing the sale plan submitted by the Secretary.

Mr. Brody.

Mr. BRODY. Mr. Chairman and Senator Lautenberg.

Senator DANFORTH. I think probably just one microphone is sufficient. You are probably getting a little echo with both of them.

Mr. BRODY. I am Kenneth D. Brody, a partner of Goldman, Sachs, & Co. and am most pleased to be here to comment to you on our role and to respond to any questions that you might have. As an aside, I might say that Goldman Sachs has been very pleased to be part of what we consider this historic process of returning Conrail to the private sector.

To complement our formal statement which you have, I would like to comment on a couple of major areas, particularly the process that has been undertaken to date and the process with which we will be dealing with the offers, and then make one subsidiary point on basically what our role as adviser to the Department has been.

Then, of course, I would be delighted to answer any questions after all our speakers are through.

The Goldman, Sachs' role has been adviser on financial matters to the Department of Transportation with respect to the return of Conrail to the private sector. We have acted in this role for a bit over 2 years. We believe we bring a good bit of financial expertise to this role.

And let me just cite a few examples of our financial expertise have that I think apply to our role as adviser to the Department. Over the past 5 years, we have been the leading investment banking firm in representing sellers of companies. Over the same period we have been the leading investment banking firm in lead-managing public offerings of common stock of industrial companies. And also over this period, we have been recognized by institutional investors as having the leading expertise in the analysis of the railroad industry.

Our general advice to the Department has been in the area of financial matters which is only part of the consideration that must take place. We have not commented on matters of public policy which are outside of our areas of expertise.

The process to date has been, I think, quite straightforward, deliberative and comprehensive. The purpose of the process has been to set an environment which would enable the Government to maximize the policy and financial objectives in the return of Conrail to the private sector. In the course of doing this, we initially conducted an investigation and analysis of Conrail, and in the course of that initial analysis, we conducted an initial buyer survey which took place in the spring of 1983 with approximately 20 prospective purchasers of Conrail.

Out of that initial buyer survey came the interest from Santa Fe; that interest was later dissipated.

This past December and January we conducted, along with the Department, a comprehensive buyers survey in which we ap-

proached approximately 110 companies and substantial individuals who might be thought to have an interest in the purchase of Conrail. The result of this rather extensive search for a buyer has been made known to you, both by the press and this morning by Jim Burnley's update on the 14th buyer.

We are pleased with the amount of interest that has been shown in Conrail. It is very, very different from the amount of interest that was being shown just 1 year ago. What we intend to do now, and what we have been asked to do by the Department is to analyze the 14 offers, and in addition to analyzing the 14 offers, to analyze a proposition of bringing Conrail back to the private sector by use of a public offering.

The major criteria or the major areas that we are going to look at in doing this analysis are, first, the value to be received by the Government. In this connection, we will take a look at cash offered, securities offered, and also any tax considerations.

The second area which we will look at is the financial strength of the resulting entity after the proposed purchase. Obviously, this is a very critical area and one which will be looked at very carefully. It is one in which there is not a simple, one numerical answer. It requires a blended judgment of a number of factors. And these factors range from the amount of cash the company has on hand, the ability to go forward with its business, the amount of debt that it must service, the amount of preferred stock that it must service, and so forth. From taking a look at those and many other financial considerations, we will come up with judgments as to the financial strength of the resulting entities.

The third area that we will take a look at is the doability of the proposal. And with respect to doability, there are a number of different areas. Let me give a couple of examples. For example, if cash is offered, one of the areas which we will consider will be whether or not the cash is on hand, or whether or not the cash needs to be raised. That is, whether the buyer is making a firm proposal or is making a proposal which then needs to be financed. A second area under the doability of the proposal is what legislation the buyer requires and the likelihood of the ability to get that legislation. And, of course, any other areas which the DOT requests us to take a look at, we shall.

Along with the paperwork and numerical analysis, in order to accomplish this rather comprehensive analysis of the 14 offers, we plan, in most cases, to talk with the proposers to flesh out completely a full understanding of the proposal and all aspects of it. Timing of our initial analysis would be expected to take approximately several weeks.

Thank you very much.

Senator DANFORTH. Thank you, sir.

[The statement follows:]

STATEMENT OF KENNETH D. BRODY OF GOLDMAN, SACHS & CO.

Mr. Chairman, I am Kenneth D. Brody, a partner in the investment banking firm of Goldman, Sachs & Co. I am pleased to have this opportunity to address the Surface Transportation Subcommittee with respect to Goldman Sachs' services to the Secretary of Transportation in connection with the sale of Conrail.

INTRODUCTION

Pursuant to section 1142 of the Northeast Rail Service Act of 1981, the Secretary retained Goldman Sachs in May 1982 to serve as financial advisor to the Department of Transportation in the sale of the interest of the United States in the common stock of Conrail. Goldman Sachs, as part of its investment banking business, is continually engaged in the evaluation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and evaluations for estate, corporate and other purposes. Over the past five years, Goldman Sachs has been the leading investment banking firm representing sellers of companies and in lead-managing public offerings of common stock by industrial companies. Goldman Sachs is also recognized by institutional investors as the leading investment banking firm with respect to expertise in the analysis of the railroad industry.

PROCEDURE FOR SOLICITATION OF BIDS

Initial analysis

Upon its retention, Goldman Sachs began analyzing and evaluating the available options for returning Conrail to the private sector. As part of its analysis and evaluation, Goldman Sachs reviewed, among other things, certain publicly available informatin concerning Conrail, including the Annual Reports of Conrail and its R–1 Annual Reports to the Interstate Commerce Commission for Conrail's five most recent fiscal years, the financial terms of certain business combinations in the railroad industry specificially and in other industries generally, financial forecasts supplied by the management of Conrail and the requirements of federal law set forth in the Northeast Rail Service Act of 1981; held discussions with members of senior management of Conrail concerning the current business and prospects of Conrail; consulted with representatives of Conrail's unionized employees and representatives of the United States Railway Association; visited certain facilities of Conrail; compared certain financial and securities data for Conrail with similar data for certain other companies in the railroad industry; and performed other tests and analyses.

Competitive bidding

The Northeast Rail Service Act of 1981 requires that the Department's plan for the sale of the common stock of Conrail "promote competitive bidding" for such common stock. Goldman Sachs advised the Department that the goal of the competitive bidding requirement—achieving the highest obtainable return to the United States—could best be achieved by structuring the sale process so that every interested and qualified potential buyer would be aware of the opportunity to acquire Conrail and would be encouraged to come forward and submit its strongest possible bid.

First buyer survey

In connection with Goldman Sachs' initial evaluation of Conrail, it was proposed that a buyer survey be conducted at a time when both Conrail and the economy were clearly on the road to recovery. In this connection, Goldman Sachs assembled a confidential selling memorandum concerning Conrail to present to the entities contacted. In the spring of 1983, Goldman Sachs conducted a preliminary survey of potential purchasers for the purpose of ascertaining their degree of interest in Conrail. In the course of this survey, Goldman Sachs identified and approached approximately twenty railroad, other corporations and certain substantial investors.

As a result of the initial buyer survey, in the summer of 1983, only Santa Fe Industres, Incorporation expressed immediate interest in the possible purchase of Conrail. The discussions with Santa Fe representatives, however, ended after Santa Fe announced plans to acquire Southern Pacific Corporation.

In the same period, Goldman Sachs evaluated a proposal that had been received by the Department from the Railway Labor Executives' Association ("RLEA"). Goldman Sachs advised the Department that it did not regard the consideration proposed therein as adequate. Goldman Sachs, with the concurrence of the Department, has held follow-up meetings with representatives of RLEA to seek to induce them to improve their offer.

Evaluation of public offerings

In the spring of 1983, Goldman Sachs developed some preliminary ideas on a possible public offering of Conrail common stock. In October 1983, with no interested buyers in sight, Goldman Sachs refined its thoughts on a public offering alternative

and presented them to the Department. At that time, Goldman Sachs informed the Department that a public offering: (1) would require new legislation in connection with the employee right of first refusal and possibly other matters; (2) would likely require multiple offerings over an extended period before all of the government's common stock could be sold; (3) would require resolution of labor issues (including, most likely, a new agreement); and (4) would depend for its success on uncertain market conditions in the future.

Second buyer survey

In light of stronger operating results and prospects by the fall of 1983, Goldman Sachs recommended that a second buyer survey be conducted to determine whether additional interest could be identified. This second survey was undertaken in December 1983 and January 1984 and approximately 110 potential buyers were contacted. Such potential buyers included institutions with a market value in excess of one billion dollars or net income in excess of three hundred million dollars and other substantial investors. The latter survey evoked an offer from Alleghany Corporation, public expressions of interest from Norfolk Southern Corporation and CSX Corporation and private expressions of interest. At the request of the Secretary, Goldman Sachs evaluated the financial terms contained in Alleghany's offer and concluded, in its letter to the Secretary dated April 18, 1984: (1) that it would be an appropriate time for the Department to invoke a sixty day time period to elicit other offers, and (2) that if no more favorable offer were received during this sixty day period (and assuming no material improvement in Conrail's financial prospects), the financial consideration proposed by Alleghany would, subject to clarification of certain tax issues, be within the range of fair conpensation to the United States for its interest in the Conrail common stock.

Offers received by termination date

After receiving this advice from Goldman Sachs, the Department established a termination date of June 18, 1984 for the submission of further purchase offers by publication of a notice to this effect in the Federal Register. By doing so, the Department acted to fulfill the competitive bidding requirement of the Northeast Rail Service Act of 1981 by requiring all their intentions known during the bidding period. Throughout the period for submission of offers to purchase the government's interest in Conrail, numerous articles concerning efforts to sell Conrail have appeared in newspapers and periodicals, including The New York Times, The Wall Street Journal, The Journal of Commerce, Business Week, The Washington Post and Fortune. As of June 18, 1984, in addition to the offers received from RLEA and Alleghany and a revised RLEA offer, the Department had received eleven offers. Such offers included the New York investment banking firm of Allen & Company; a group of investors led by Citycorp; Consolidated American Transportation Systems, Inc.; CSX Corporation; First Allied Corp. of Rochester; Guilford Transportation Industries, Inc.; Mr. Arthur E. Imperatore; a group consisting of Mr. J. Willard Marriott, Jr. and certain members of the Bass family of Fort Worth; Norfolk Southern Corporation; Mr. Kenneth Perryman; and Tippecanoe Warehousing, Inc.

CRITERIA FOR DETERMINATION OF BEST OFFER

General

Goldman Sachs is currently in the process of reviewing and analyzing the financial terms of the proposals received within the last week and reevaluating the offers made by RLEA and Alleghany in light of the new proposals. Because this review and comparative analysis is not yet complete and will require several weeks to complete, it is premature for Goldman Sachs to comment at this time upon the relative advantages and disadvantages to the United States of the financial terms of the various offers. The Subcommittee has accordingly requested that Goldman Sachs provide an explanation of the criteria that Goldman Sachs is applying in the evaluation of these offers.

Although the sale raises a number of important public policy issues (such as ensuring fair and equitable treatment of labor, shippers and the Northeastern states) Goldman Sachs recognizes that those issues should properly be resolved by the appropriate public officials with experience and authority in this area. Therefore, although Goldman Sachs has been available to consult with and advise the Department with respect to the effects of various plans for the sale of Conrail upon these interested parties, its primary roles have been: (1) to assist the Department in developing a sale mechanism designed to produce the best possible purchase offer; (2) to advise the Department with respect to the comparative economic values of the vari-

ous offers to the United States; (3) to assist the Department in its determination (required by the Northeast Rail Service Act of 1981) that the sale ensure continued rail service in the Northeast by analyzing pro forma and related data concerning the financial strength of the entity which would result from a sale of Conrail to any of the various bidders; and (4) at the request of the Secretary, to evaluate the offers received as compared to a disposition of the Conrail common stock involving a public offering.

Evaluation of financial terms of purchase offers

One of the goals of any plan for the disposition of the interest of the United States in the common stock of Conrail is the maximization of the return to the United States on its investment in Conrail. Accordingly, in evaluating the financial terms of the offers, Goldman Sachs is estimating the present value to the United States of the securities and other non-cash consideration included in the various offers (e.g., the warrants offered in the Allen & Company proposal).

In addition to the direct purchase price offered by potential purchasers, Goldman Sachs is also examining the amount, if any, of revenue gains or losses to the United States resulting from the tax effects of transactions proposed by the various offerors.

Finally, Goldman Sachs, since its retention in May 1982, has undertaken to identify and promote interest among potential purchasers in acquiring the Conrail common stock and in that regard has evaluated the market's response to the prospective sale of Conrail. Goldman Sachs believes that the value of Conrail is primarily determined by the price resulting from a competitive sale process which includes a number of informed and willing potential buyers. We believe that the offers received demonstrate the effectiveness and scope of the competitive sale process. The market valuation reflected in the competitive sale process just concluded will also, of course, be subjected to assessment in terms of traditional financial criteria.

Ensuring continued rail service

The Northeast Rail Service Act of 1981 also requires that the plan of sale ensure continued rail service in the Northeast following the sale. Accordingly, Goldman Sachs is analyzing each of the outstanding purchase offers in order to give the Department its assessment of the resulting entity's creditworthiness and financial strength. Goldman Sachs' analysis in this area focuses upon the financial resources, liquidity and access to capital of the various offerors, as well as the pro forma projections of the combined companies following the acquisition.

FINANCIAL STATUS OF CONRAIL

During the period of Goldman Sachs' engagement as financial advisor to the Department, Conrail has substantially improved its operating performance and financial condition under the leadership of Stanley Crane. While the recent economic recovery has assisted Conrail's earnings gains in 1983 and 1984, management's rationalization of Conrail's business, facilitated by the Northeast Rail Service Act of 1981 and other legislation and cooperation from organized labor, has contributed substantially to Conrail's current improved financial condition.

Thank you for the opportunity to present our views. I would be delighted to answer any questions you may have.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR LONG AND THE ANSWERS THERETO

Question. In your prepared statement, you indicated that one of the goals of any plan for the disposition of Conrail "is the maximization of the return to the United States on its investment in Conrail." To what extent should non-financial returns be considered, such as the value of a Conrail sale as a model for other railroads and industries? How might such non-financial returns be evaluated?

Answer. The Northeast Rail Service Act of 1981, as amended ("NERSA"), directs the Secretary of Transportation (the "Secretary") to engage the services of an investment banking firm for the purpose of arranging the sale of the interest of the United States in the common stock of Conrail. Accordingly, Goldman, Sachs & Co. ("Goldman Sachs") was retained by the Secretary effective May 1, 1982 to advise the Department of Transportation (the "Department") with respect to the proposed disposition of all or a portion of the interest of the United States in Conrail. Goldman

Sachs' services in advising and assisting the Department have included, among other things, providing financial advice, conducting a diligent search for acceptable purchasers, assisting in formulating and preparing a plan for submission to Congress, and assisting in negotiations.

NERSA provides that any plan for the sale of the interest of the United States in the common stock of Conrail must ensure continued rail service, promote competitive bidding, and maximize the return to the United States on its investment. In advising and assisting the Department with respect to the financial aspects of a plan of sale, Goldman Sachs recognizes that the maximization of the return to the United States on its investment must be balanced with other policy concerns such as the viability of the resulting entity and equitable treatment of employees in the process. Goldman Sachs, however, has deferred and will defer to the appropriate officials on the numberous public policy issues arising under any plan of sale.

In rendering financial advice concerning this transaction, Goldman Sachs has drawn upon its broad experience in dealing with all types of business arrangements. In this way, it has attempted to facilitate the government's efforts to achieve all of the gosls of NERSA to the maximum extent feasible.

Question. In your prepared statement, you testified that Goldman Sachs' analysis will focus upon the "financial resources, liquidity and access to capital of the various offerors . . . ." To what extent should consideration be given to potential "concession capital", i.e. the willingness of employees to reduce wages, or their access to other forms of capital?

Answer. Goldman Sachs' analysis of the outstanding offers has focused on the financial viability and credit-worthiness of the entity which will result from the proposal sale. Such focus stems in large part from NERSA's goal that continued rail services be ensured. If the resulting entity were not viable, that statutory goal, from a financial viewpoint, could be thwarted.

Most of the offers received by the Department do include proposed arrangements for some ownership participation by employees in the resulting entity. Goldman Sachs has consulted representatives of labor throughout the sale process. In performing its analyses of various sale proposals, Goldman Sachs has considered the financial implications of possible wage concessions and employee ownership arrangements in light of NERSA's goals.

Question. How does Goldman Sachs evaluate and measure the contribution of the employees to Conrail, specifically, and to any enterprise in which the employees have substantial participation and ownership? Do traditional analyses need to be modified to include consideration for the value and contributions of the employees?

Answer. Generally, Goldman Sachs has relied upon traditional analyses to evaluate the potential involvement of employees in the ownership of the resulting entity. Department officials, offerors and representatives of labor are considering the nonfinancial aspects of such employee ownership. Goldman Sachs has been involved in consultations with these parties.

Question. How would employee participation affect the development of a "sale mechanism" and the analysis of "financial strength" formulated by Goldman Sachs and referred to in your prepared statement.

Answer. As indicated in response to Questions (2) and (3), respectively, many of the offers involve varying arrangements for employee ownership, representation on the Board of Directors and other benefits (or concessions) and offerors have consulted with representatives of labor concerning those arrangements. The various employee arrangements affect the resulting entity in different ways. Goldman Sachs' analyses of these arrangement have included, among other considerations, the effect on the financial strength of the resulting entity; the effect on the return to the government; and the financial effects on agreement and nonagreement employees.

Mr. Wells.

Mr. WELLS. Thank you, Mr. Chairman and Senator Lautenberg, good morning.

I am pleased to appear here today to discuss the Conrail sale process with you. USRA's chairman, Steven Berger, who had to be out of the country this week because of longstanding business commitments, has asked me to describe how the USRA staff will evaluate the sale proposals.

In speaking in my capacity as Staff Director for USRA for the Conrail evaluation work, I cannot and therefore do not necessarily speak for the Board of Directors or any individual director. The

unique contribution of the USRA staff is to provide a common basis to all of the directors of authoritative factual information and technical analysis.

I cannot predict the manner in which the Board will make use of that analysis and convey that work or its recommendations. Various of our directors are involved in the sale process in one way or another. And, of course, I cannot predict how such roles will affect how the Board as a whole will function in this manner in the next few months.

Historically, USRA's congressional mandate, from time to time, has included topical questions about Conrail matters to be addressed from a quite broad public policy spectrum. Before NERSA was passed in 1981, the makeup of our Board of Directors in fact symbolized that broad spectrum. The Board had been a constituent enterprise until that time, composed of representatives of union employees, shippers, local communities, the financial community, the railroad industry at large, and of course, the various Federal agencies that were party to the Conrail matter in one way or another.

While NERSA made significant changes in our Board, it did retain the non-Federal members of the previous Board as an advisory group, and NERSA did not narrow the focus of USRA's analytical work. Accordingly, we have to assume that we could bring to bear a variety of factors in our analysis of the proposed sale transaction.

However, it is very difficult for me to say at the present time exactly what those factors would be. And in a sense, all I can do is outline possibilities today. The Conrail sale process is still, in a sense, in the early stages. The offers received in some cases are very general or at least highly conditional.

The Secretary of Transportation, of course, has not had the time to select the most attractive one, and could even at this point decide that none of them are adequate and suspend the sale process temporarily.

The nature of the analytical work that we will eventually do when the time is right is going to be shaped by three major factors that have yet to be determined. The first is the nature of the proposed sale itself, and by that I simply mean that one type of transaction could have quite a different analytical requirement than the other, the difference between rail buyers and non-rail buyers being perhaps the easiest example.

The second factor is how much time is available to do the analysis. Perhaps the best illustration there is that if USRA is given only a very short period of time to evaluate traffic diversion and competitive effects of a proposed rail purchase of Conrail, then obviously we cannot provide in a brief period of time the same level of detail or scope of analysis which the Interstate Commerce Commission has traditionally taken well over a year to conduct with the aid of a much larger staff and, of course, copious consulting studies and briefs filed by proponents and opponents of such transactions.

The third factor is the precise nature of the evaluation requests that we receive from the Congress, and in a sense this third factor does embody the two that I have already discussed. However, the

nature of the congressional request will perhaps clarify other concerns as well. For example, whether we will be asked to evaluate only the proposed transaction that is approved and sponsored by the Secretary of Transportation or, in contrast, whether we would be asked to provide some sort of comparative analysis of all the offers that have been presented or at least the offers that might still be being promoted by their proponents, despite being projected by the Secretary.

Now, as determined and more specifically defined by these kinds of factors over time, the scope of the USRA staff work will include, in large measure, the sorts of criteria that Mr. Burnley has suggested that the Department is in fact using to evaluate the offers and the sorts of questions that Mr. Brody indicated that Goldman, Sachs would be looking at.

Basically, you can view these as breaking into areas. First is financial analysis that would be applied to any proposed sale, regardless of the type of buyer. And this would basically have, as I see it, four components. One would be the financial benefits to the Federal Government. Second would be the financial position of Conrail after the sale. Third would be the financing terms and sources of the price raised by the offeror. And finally, the potential return on the investor's purchase price.

Now, to the extent that a rail offer is the proposed transaction or is the offer that we are asked to evaluate, we would go into additional analyses which you could call impact analyses, and these probably can best be characterized in three areas. One is transportation services impact; the second would be employment impact; and a third would be competitive impact, which to some degree can be distinguished from a transportation service study.

Now, the brevity of that list is perhaps deceiving, and I want to emphasize that once our mandate has been defined and the sales transaction has been clarified and better defined itself, our work plan, if you will, grows quite complex quite quickly, particularly in the case where an analysis of the potential rail merger is involved.

In preparation for the possibility of having to evaluate a Conrail sale, USRA staff has been working to update two very important baseline studies that will enable us to take another look at Conrail's future earnings prospects, regardless of who owns it. One of these studies is on Conrail's 1983 performance, and the other is a comparative study with Conrail's major rail competitors.

We are at the same time preparing in all the ways we can to have a running start on a sale evaluation. Data bases are being obtained and organized to facilitate rail merger evaluations in particular because of the long lead time necessary to prepare for that sort of work. And we are also doing special studies such as Conrail's Federal Income Tax status.

I brought along with me this morning an illustration of one of the sorts of tools that we are using at a rather general level of analysis, to get an idea of the relative railroad geography that we would be looking at in the case of a rail merger proposal. This lets us look very quickly at the key issues in network duplication and rail competition.

Dan Norris of our staff will help me by doing some pointing as I go through these very quickly. What we have here is a series of

color overlays. We will look just at the eastern network, and we will start with Conrail and then add its major competitors, the Northfolk Southern and the CSX System, and then we will look at Guilford as well.

You have Conrail there now, and the most notable fact about Conrail is that it is the largest and most pervasive railroad in the Northeast. It serves all the major population and industrial centers. The Northeast still produces the majority of the Nation's steel and automobiles, originates substantial quantities of coal and grain, and is a major consuming area.

Conrail generally has the best network of rail lines connecting these markets, in terms both of capacity and desirable engineering attributes. Conrail's major traffic flows tend to be east-west, out of Boston, Pittsburgh, New York in the East, and the major gateways in the West are Chicago and St. Louis. And Conrail has the largest east-west TOFC flows of any of the eastern railroads.

Dan, if you would put CSX up now—and the order that I am going to go through the other systems is the largest to the smallest. CSX is the largest.

The first observation about the CSX system is that it reaches most of the major markets except for the area east of Rochester, Hagerstown, and Philadelphia. Chessie has a strong presence in most major automobile and steel industry markets, and is the largest coal hauler in the region.

In competition with Conrail, the issues of competition and rationalization would be very significant. For example, the issue of port preference for coal traffic among Norfolk, Baltimore, and Philadelphia would be of some concern. Container traffic movement would be of similar concern among these ports, plus New York and Boston.

Norfolk Southern has a fairly large presence in Conrail's service area. Somewhat similar to Chessie, NS serves a number of major Conrail markets, but is generally the lesser competitor both in number of markets and in size of presence. It does not serve the area east of Buffalo, Pittsburgh, and Washington. However, it does cross the Mississippi River to reach Kansas City, unlike either Conrail or Chessie.

Its routes and traffic patterns tend to be more east-west than either those of Conrail or CSX.

Initial consideration of a Norfolk Southern combination with Conrail would yield some concern for competition and rationalization, although less so than for a CSX combination. The greater port preference issue here may be among the Great Lakes ports of Toledo, Sandusky, Huron, Cleveland, and Ashtabula.

Generally, the overlapping Norfolk Southern lines have the least tonnage due to lesser market presence, compounded by deregulation and route closings over the last 2 years.

If we could see GTI now.

Guilford Transportation Industries is, of course, the smallest of the eastern rail systems, and its market geography is both competitive with and supplemental to Conrail's network in the northeast. It competes with Conrail through Montreal and in eastern Pennsylvania, New York State, and southern New England. It extends beyond Conrail's service area into New England.

A consolidation of GTI with Conrail would produce the least concern for competition and rationalization, since it serves the fewest common markets and has the fewest parallel lines. In fact, a good portion of GTI's routes are presently trackage rights over Conrail west of Binghamton and south and east of Wilkes-Barre.

Now, with all the maps up there together, very quickly, I would just like to make a couple of comments in closing. The visual overload that one gets with all four systems is in its own way instructive. There is a great deal of overlap among the northeastern routes.

One thing that should be noted as well is that an acquisition of Conrail by either Norfolk Southern or CSX would sharply reduce GTI's friendly connections. Looking at the maps as a whole is a reminder that Conrail and GTI are pure northeast carriers, whereas CSX and Norfolk Southern are more nearly full-service railroads east of the Mississippi, serving the south quite extensively.

This concludes our prepared remarks. I would be happy to answer any questions that you may have.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWER THERETO

Question. There has been much discussion about whether now is the appropriate time to sell Conrail, and also whether Conrail can survive as an entity in the future. Given your ongoing financial analyses and projections for Conrail, what is USRA's assessment of these questions?

Answer. USRA is presently engaged in a comprehensive review of Conrail's own assessment of its prospects for the 1984-88 period. The information gleaned so far from our persual of Conrail's outlook, in combination with other analyses we have performed in the past, suggests that it is reasonable to expect Conrail can survive as an entity.

On the other hand, it must be admitted that such a conclusion is far from certain or guaranteed, and inded that mere survival is not necessarily a sufficient incentive for private investment. The fundamental economic forces that will shape Conrail's future are in an unusual state of flux. The company's operating economics are rapidly changing. Severe reductions in employment, physical plant, and demand for the company's services over the past eight years make it difficult to assess the underlying economics of the remaining operations. Conrail has improved its performance vis-a-vis other major U.S. railroads to the point that in some cases its productivity rates are superior to industry averages. Future improvements must therefore come from performance gains may be necessary to counter the impacts of future railroad mergers and increases in truck size and weight limits. Finally, perhaps the greatest uncertainty affecting Conrail's future is whether or not Conrail can reverse the long-term historical decline in demand for rail service in its area. Conrail believes that previous traffic declines have eroded much traffic that had been produced in economically obsolete plants or subject to intense truck or rail competition. The traffic that remains, while still subject to fluctuation from business cycles, is thought to be less vulnerable to the secular decline that the territory has experienced for the last 30 years. However, there is no perfect analytic predictive basis for such judgments.

Conrail's traffic outlook dilemma provides a useful focus for answering the question of whether now is an appropriate time for selling Conrail. The offers for Conrail so far appear to rely on the railroad's cash position and potential tax and other non-operating benefits while putting little or no value on Conrail's potential future operating earnings. It might be argued that such valuations were to be expected in light of Conrail's brief earnings history and its historical traffic trends. An alternate perspective would be that NERSA's intent—of preserving Conrail as an entity only if it could be profitable—is better served by waiting until prospective purchasers demonstrated higher confidence in Conrail's operating profit potential. This line of argument does not justify delay because of the speculative possibility of a higher sales price, but rather asserts that the policy choice between entity sales and other

disposition alternatives should wait until there is broader and stronger consensus about Conrail's earnings possibilities in entity form.

Question. Questions have been raised about the adequacy of the financial return to the Federal Government included in the various offers. What would USRA judge to be an appropriate price for Conrail, and how would you arrive at this figure?

Answer. The best determination of the value of a company is the free market, where a willing buyer and willing seller can enter into negotiations with neither obligated to agree to a transaction it does not find acceptable at that time.

The cash flow that Conrail can be expected to generate in the future is primarily what is being acquired by a purchaser. In order to estimate the possible range of future Conrail cash flows available to a purchaser, factors such as the following must be assessed:

The economic outlook for Conrail's service area and customer industries.

Revenue impact of truck competition trends.

The rate of cost inflation and how much can be recovered through rate increases.

The cost of moving the projected traffic.

The cost of maintaining and replacing necessary plant and equipment.

Nonoperating income and expenses.

Federal income taxes or benefits.

Volatility year-to-year in any of the above, and confidence in the ability to project any of the above.

Assets including cash, available for other income producing purposes.

After analyses such as these, a buyer would have some idea of what the cash flows of Conrail would be on a stand-alone basis. If the potential purchaser were to be another railroad, then additional factors arise:

Traffic to be diverted away for other railroads.

Economies to be realized by elimination of redundant lines and facilities.

Savings in overhead expenses to be achieved by consolidation.

Some types of sale transactions may introduce other valuation factors, and generally it is not possible to set value in the absence of the specific terms and conditions of a particular transaction.

Question. You have indicated that in evaluating the various offers you would perform an impact assessment, which you have explained in some detail where the offeror is a rail entity. With respect to a non-rail offeror, what factors would you review in making such an assessment?

Answer. Nonrail offers primarily invoke financial concerns. These would include cash and other consideration received by the Federal Government, the financial strength of Conrail and the offeror after a sale, the source of the purchaser's financing, and the like. However, we would also evaluate impact in terms of employment, competition, and service if the structure or terms of a particular nonrail offer were to suggest that these factors would be influenced as a result of the sale transaction.

Question. You have also indicated that the type of analysis that USRA could do with respect to the sale of Conrail would depend upon what is requested. Without a specific request from Congress, what type of review would you expect to conduct? Would you anticipate doing any analysis for use by the Department of Transportation, and if so, what would such a review entail?

Answer. A common element to the evaluation of any offer will be a final, pre-sale appraisal of Conrail's long-term economic outlook or prospects, and we are now conducting the studies necessary for such a judgment. This undertaking heeds the purpose of the process established by NERSA, one in which sale of Conrail as an entity would be predicated upon the expectation that Conrail remain profitable once returned to the private sector. This issue has taken on added significance because of the assertion by two offerors, Norfolk Southern and CSX, that Conrail's long-term prospects are dubious as long as there are three major rail systems competing for the traffic available in the Northeast.

There are three major components to our ongoing evaluation of Conrail's prospects. First, we are updating our annual performance review, which utilizes special techniques to evaluate Conrail's success in achieving sustainable or permanent improvements in productivity and efficiency. Secondly, we are updating our comparison of Conrail with its major rail competitors, a data base which allows us to draw some inferences about Conrail's opportunities for further progress in cost control. Finally, we are analyzing a revised outlook for the next five years prepared by Conrail's staff and supplied to USRA early in June.

I should also mention that, as part of our efforts to prepare proforma financial statements for future forecast periods, we are doing a special federal income tax analysis to take account of the possibility that the sale transaction would be struc-

tured so as to eliminate Conrail's tax loss carry forwards and investment tax credit carry forwards.

As I mentioned in my prepared testimony, we also are taking a number of steps to prepare for the possibility of having to evaluate a rail offer. Rail merger evaluation would be more complex than that required for nonrail offers, and we have been working for several months to prepare computerized data bases and other analytical aids that would allow us to do this sort of work efficiently if it becomes necessary.

None of these tasks are being done at the express request of the Department of Transportation. However, we disseminate the results of our work to all members of our Board of Directors, which as you know includes the Secretary of Transportation. For major studies such as these in the past, we have provided our Directors and their staff ample opportunity to review and critique our work. We will use a comparable process for the tasks outlined here. Interim results of some work already have been shared with the Department of Transportation at its request.

QUESTIONS OF SENATOR LONG AND THE ANSWERS THERETO

Questions. In your prepared statement, you indicated that the United States Railway Association will conduct "financial analyses" with consideration given to "financing terms, sources of purchase price." Does ths mean that an asset leveraged buyout will not be considered? Does this then preclude the participation and ownership proposed by the Conrail employees?

Answer. We have not ruled out an asset-leveraged buyout nor the participation and ownership proposed by employees in their offer to purchase Conrail. However, we do think it is appropriate to measure and describe the extent to which any particular offer does or does not utilize various forms of direct and indirect leveraged buyout techniques.

Questions. In your prepared testimony, you also indicated that USRA will conduct "impact analyses" with consideration for "transportation services", "employment", and "competition." To what extent will such impact analyses include consideration for the precedential value of the Conrail sale, particularly with regard to the employee contributions and ownership of Conrail serving as a model for other railroads, industries, and nations?

Answer. We will include such factors in our impact analyses.

Senator DANFORTH. Thank you very much.

Looking back to 1981, when at least I did not think we were going to have anything like 14 bidders, it would appear to me as though the timing has been most fortuitous. Would you agree with that? In other words, if Conrail is to be sold, isn't this the time to sell it?

Mr. BURNLEY. We do think there is a good deal of truth in that, Senator. Again, we do not feel, however, that we have to be driven by the calendar in this exercise, and that should it turn out upon analysis that all 14 of these offers are seriously deficient in one way or another, the Secretary does reserve the right to come back to the Congress and say that in good conscience she cannot recommend any one of them.

I should note, however, that given current economic conditions and given the remarkable improvement in Conrail's performance, that the timing does seem to be fortuitous. Certainly I agree with what Goldman Sachs has said to us in recent months. They would prefer that although one would speculate—and I would certainly like to predict that particularly in the region which Conrail serves there is an ever-brighter economic future far beyond the horizon—nonetheless, you cannot bet the farm on that sort of thing. We do not want to bet the future of northeast rail service on that which we do not know and can only speculate about.

Senator DANFORTH. As you pointed out, the Secretary does have the option to reach the conclusion that none of the 14 possibilities

is satisfactory, and therefore it is necessary to go back and try it again.

Mr. BURNLEY. Yes, sir, we do.

Goldman, after looking at the Alleghany offer in April, came back to the Secretary and said that looking at it purely on its financial terms, laying to one side the public interest issues that Mr. Brody has deferred to the Government on, that they felt that Alleghany offer was within the parmeters of serious offers that the Secretary ought to consider. And based upon that conclusion, we then set the deadline of last Monday.

And we do feel, as I said in my prepared statement, that an indefinite lengthy period of suspense serves the interest of no one, and certainly is not in the interest of Conrail's employees or of the people that depend on it for service. And it does not serve the U.S. Government's interest.

Having said all that, obviously the Secretary would much prefer to be able to come to the Congress in the near future and say that in fact one of these offers does seem to be quite attractive and, looked at from all the angles we talked about this morning, worthy of acceptance. But she very explicitly is reserving the right to come and say to the contrary, with a sense of substantial disappointment, we do not have such an offer before us.

The only reason we are not ready to speculate one way or the other this morning is, since we just got most of the offers Monday, we have a lot of work to do.

Senator DANFORTH. Does she also have the option of saying, well, of the 14 bids, we think one of them is clearly preferable to the other 13; however, it could be better and we would like to do a little further negotiating? Is that an option?

Mr. BURNLEY. Mr. Chairman, in fact we anticipate further discussions. I do not know whether they are more accurately characterized as negotiations or simply discussions. But we have got a lot of questions about several of the offers that came in Monday. A couple of the offers were sent in by people we had never heard from before, and we literally do not know as we sit here this morning who stands behind those offers.

So, obviously, we have got to go back to the folks who sent offers in and have further discussions with them, and we hope to narrow very quickly the range of those with whom we have continuing discussions. And we would hope to, within the very near future, be able to talk to one or two or three of those who have made the most serious offers, and then the Secretary can come sometime hence to the Congress and say, having gone through these additional discussions, I am convinced that what I have before you is the best offer and/or the offer.

Senator DANFORTH. But it is not like a sealed bid process. This is a situation in which you could go back to one of the bidders and say, well, you have submitted a good bid; but we would like to see certain features be part of the bid. Couldn't they then adjust the bid to take into consideration your concerns?

Mr. BURNLEY. Yes, sir, that is correct. But I do think we would have an obligation if we went back to that particular bidder and said these are the necessary minimum criteria that you do not yet meet—you have to meet them—to also make that known to the

other bidders and give them the same opportunity to address our concerns. It is not a sealed bid process.

It is, on the other hand, competitive. And we have got to be even-handed in how we treat those who have put a good deal of time and effort into preparing bids. Some of these bidders have spent very substantial sums of money and time in analyzing traffic data. A number of them have sent teams out on the Conrail system and toured the system, with the cooperation of Conrail's management making that possible for them.

So we really feel an obligation to be sure that the process does not tilt in one direction or the other, and contrary a little bit to the sealed bid process, to make sure that the light of day is thrown on every concern that we have.

Senator DANFORTH. It is also possible, isn't it, that you could combine a couple of the bids or more?

Mr. BURNLEY. That is a possibility, Senator. We, however, do not feel it is an appropriate role for the Department to dictate to anyone in the private sector—and aside from being appropriate, we would probably fail abysmally—just how they will fashion their offers.

So we certainly expect that there may be some further discussions. In two or three cases we have noted already, it would appear that only part of the financing has been lined up behind the offers, and it would not be entirely surprising were a couple of these bidders to get together in the next few days or weeks and come back with some sort of financial arrangement among themselves.

Senator DANFORTH. Well, I think the point is, as I understand it, you are now in a very flexible process. It is not so flexible that nobody can count on anything, but it is flexible.

Mr. BURNLEY. Yes, sir. Let me just comment. There is one area where we may appear to be a little more rigid than at first blush would make everyone comfortable, but nonetheless, we feel we have an obligation to be a little rigid. And that is with respect to the deadline of last Monday. Mr. Brody has outlined for the committee today the very extensive process which began a year ago and which had a second wave back last Christmas season, of literally canvassing the country for prospective bidders.

We have got a great deal of confidence that we have now identified all those who have a serious interest and the resources to back that interest up, in this country who would like to bid for Conrail. Again, a number of these bidders have expended very substantial resources in preparing bids. So we do feel that it would be unfair, frankly, for us to leave the process so open that 2 or 3 weeks from now, someone who has not been a player in the process to date suddenly appears at our door and says we would like to make a $1.1 billion cash offer and give you your NOL's and ITC's and it is worth $2½ billion total, whatever the bid might be.

That really would be a breach of faith with all the other people involved in the process. So while we are leaving open, as far as we can, the door to discussions among those who are now in the process, we do feel that it would be inappropriate for new folks to show up and be invited into the process, since we were quite public in our announcement that we wanted everyone at the table as of last Monday.

Senator DANFORTH. Mr. Brody, is it fair to say that there is no iron law on selecting the best bid? This is really a judgment call, isn't it? It is not a sealed bid situation, or a very simple procurement situation where you select the best bid based on dollar terms. This is a situation that requires a considerable amount of judgment as to the selection of the bid that provides the best deal for Conrail.

Mr. BRODY. I think that is absolutely accurate, Mr. Chairman. The understatement of the day would be for me to say that this is clearly not a simple process. Indeed, there are many factors to be evaluated which go beyond the typical sale of a private company to another private company. Even in the process of the sale of a private company, it is not necessarily a simple process.

So, I would say here that the process is one which is quite complex, and which in the final analysis requires judgments to be made which are not going to depend solely or even close to solely on the numerical analysis that results. It seems to us it is a highly judgmental matter.

Senator DANFORTH. Is one of the things you are looking at the desirability of a public offering of stock being part of the package?

Mr. BRODY. The Department of Transportation asked us as part of our analysis of the 14 offers to include another possibility, and that possibility is bringing Conrail back to the private sector by means of a public offering, and we shall do so. We have done some work on that in the past, and should be able to do that within the same period of time that we do the analysis on the other 14 offers.

Senator DANFORTH. Any preliminary thoughts?

Mr. BRODY. I really think it is too early to have any preliminary thoughts. We certainly have not had much time to do a full analysis of the 14 offers, although it is fair to say that one of the reasons that we are able to move along in a reasonably speedy way is that we have had significant discussions, or the Department has had significant discussions, with many of the offerors.

But I think it would not be appropriate for us to try to prejudge the matter here.

Senator DANFORTH. Mr. Burnley, I want to ask you about your idea of what the role of Congress should be. It is my understanding that the law does not require congressional approval of the sale, and that the decision really is in the hands of the Department of Transportation. Is that correct?

Mr. BURNLEY. Mr. Chairman, as tempting as it might be for a representative of the executive branch to jump upon such a wide open invitation to say "yes" I will resist, because in fact our view is somewhat different. We are all familiar with the decision by the U.S. Supreme Court last summer which found unconstitutional the legislative veto provisions in many statutes, and the NERSA act is one of those statutes where clearly that provision is no longer operative.

It has been our position, however, since the *Chadha* decision that the language in NERSA which requires us to come to the Congress for a review period is still valid and constitutional, and is severable from the legislative veto provisions. So we think that, clearly, not only that the Congress should have a role, but that NERSA still requires that the Congress have a role of oversight and review.

Beyond that, we have been convinced for quite a few months now, having looked with some care into the legislative framework to which Conrail is presently subject that it was literally impossible to fashion a transaction no matter how hard you might try that would not require amendments to one or more statutes.

For example, we think that one of the very important goals here ought to be that the Federal Government terminate its involvement in Conrail. There is just no way you could justify, for example, having Conrail alone among all the class I railroads in this country subject to special scrutiny by any Government agency or department. It needs to be no more or less scrutinized than every other significant railroad in this country.

So, there are those kinds of provisions in current law that must be addressed by the legislative process, and as my prepared remarks indicated, we intend to send to the Congress in the very near future, as soon as we can finish working it through the executive branch and consulting with USRA, a process we have begun this week, a legislative package which proposes to fix those things that we think need fixing.

So the Congress will clearly have to act in an affirmative way, we think, before any sale can be completed.

Senator DANFORTH. All right. The one point I want to make is this. What we have in Congress is 535 George Steinbrenners. We know exactly what to do in everything.

Mr. BURNLEY. We agree with that emphatically, that you know exactly what to do.

Senator DANFORTH. And are all too willing to tell you. I think that in putting together the best possible arrangement for Conrail, it is really important for the Department to use the judgment that it has and for it to draw on the best advice that it can draw on, and I have no doubt that that is Goldman, Sachs. We certainly are going to be attentive to what you have to say.

We are having a hearing today, and we plan to have another one in late July. Incidentally, would the timing of that second hearing work out all right?

Mr. BURNLEY. It is difficult to say with any certainty today, Senator, because again we have got some new offers that we have had no opportunity to scrutinize, and we do have to consult with other departments and agencies in the executive branch, and we intend to have extensive discussions with USRA and with Members of Congress before, not after the Secretary comes forward to you with a proposal.

Our hope would be that we might have something noteworthy to say some time later this summer, but I would like, if I may, to duck the opportunity to be bound to a precise schedule.

Senator DANFORTH. We can work that out with you. However, Congress is not going to be around much. We have a couple of conventions this summer, plus the elections later. You may be assured we will be in touch with you about what would be the appropriate date.

The point that I want to make is that obviously we do not want to just close our eyes and say, well, this is a delegated responsibility, let DOT do it, Congress has nothing to say about it. We are going to be looking at it, and we are going to be holding a hearing

at some point, and we are going to have legislation dealing with the implementation of any sale, as you pointed out.

At the same time, I want to make clear my own view that I think the future of Conrail is best going to be served not by 535 George Steinbrenners. Instead, I think it is best going to be served by you and the experts that you have retained in the person of Mr. Brody and Goldman, Sachs, using your best judgment and applying the criteria set out in your testimony, particularly the criterion on the future of Conrail. What is important is what is going to be best for the strongest future for Conrail, for the shippers who are dependent on Conrail, and for the people who are employed by Conrail. I have confidence that this is going to work out very well.

I take it, though, that there is nothing that is absolutely foolproof. I mean, there is no way that the Government can sell Conrail and then be certain that 5 years from now there would still be such a thing and that whoever buys it would not have the legal option to liquidate it at some future date. There is no way to tie them in, or is there?

Mr. BURNLEY. Mr. Chairman, we certainly would share the view that ultimately you cannot guarantee the long-term success of Conrail or any other major corporation in this country.

However, as we look at the various offers before us and as we continue our discussions with those who do have offers on the table, we do feel that there are some things that we can do through the contractual process that leads to the ultimate sale of Conrail that at least give us some better assurances than we may have otherwise as to Conrail's future.

Some of the bidders have, in discussions with us, and I think when you scrutinize the offers you will even find some indication of this in the written offers, made some unilateral offers to either pledge not to merge with a particular kind of entity or not to pay out dividends at a rate that would threaten Conrail's capital base and the need to reinvest, that sort of thing.

Those are all elements we are going to look at very, very carefully in this process, and we do think that some of those elements can be addressed in the actual sale documents, but beyond that, again, our goal is to return Conrail to the private sector fully and completely, and we hope that through this process we and the Congress will quickly come to a consensus as to how best to do that.

But having done it, we then have to depend upon Conrail just as we do the other major class 1 railroads, including those that were on the overlays displayed here, to stand on its own feet.

Senator DANFORTH. Senator Lautenberg.

Senator LAUTENBERG. Thank you, Mr. Chairman.

It is interesting to see the changed attitude about Conrail. I thought all of you had very good testimony to offer. Mr. Burnley covered a number of issues that I think are critical in terms of my view of what has to happen here.

It is amusing almost to see what has taken place in terms of the view of this property, if we can call it that, from a total drag on the market to editorials that talk about how we ought not to rush to sell Conrail and how the price is not fair in some cases, and suddenly Conrail has turned into a gilt-edged piece of property.

I am sure not going to discourage any buyer. These are sophisticated people out there, obviously, by their ability to conceive and construct these deals in addition to in many cases having sufficient sums available for capital to go ahead with this deal.

Mr. Brody, you are a professional in a highly professionalized business, with a very good company, notwithstanding your modesty about the accomplishments of Goldman, Sachs.

But I look at the balance sheet and the income statements here, and there has been sudden improvement in performance here and good expense control. The number of employees is down about 50,000, 60,000 from its peak. How much more room is there for improvement?

By the way, considerable sacrifice has been made by the employees, and I think they expect to get back some of that contribution they have made since 1981, if the date is correct, in terms of sharing in the new venture.

Have you analyzed the sale of Conrail in terms of doing any income projection? We are not hiding anything from any potential buyer, but if we have not seen all the improvements, have you analyzed the income projections for Conrail? Do you think we can continue to see the kind of profitability that has been developed in this last year?

Mr. BRODY. That is a long question.

Senator LAUTENBERG What I am trying to get to—what I want to get into focus—is, whether or not this is appropriately priced. Although I think everybody has said, and we all understand, that this is not the principal criterion, it is nevertheless a factor, and it is going to be the one that people can pick on and say, aha, here is another Government giveaway.

I just want to make sure that the record is quite clear about what the projections are for Conrail, to see if we can respond to the notion that it is somehow or other a diamond in the rough, a rough diamond.

Mr. BRODY. Let me make a number of comments to your question. First, let me comment on the notion of value, and then second, let me comment on the actual earnings position of Conrail and the future outlook of Conrail.

To start out with, it seems to us that there is a relatively simple notion of value which is a very good and useful notion of value. That notion of value is what a willing buyer would pay a willing seller with each having full information. And that notion of value is not what experts or so-called experts with an extreme amount of financial analysis think that a buyer should pay a seller for a property.

A large part of this process has been designed so it has facilitated all sorts of prospective buyers to come forward, to put their best foot forward with proposals so that we can really get a value for Conrail. I would submit that the 14 offers have validated that part of the process, and that indeed the actual market forces working really have more to say about value than what some so-called expert might say based on manipulation of numbers.

That is a point on value which sometimes is at odds with some of the things you read people writing who do not have much experience in the selling of companies.

The second comment I would make is with respect to earnings. A number of times when earnings of Conrail have been talked about in the press, there has not been full disclosure—as we would call it in our business—as to what actually is there.

Let me just backstep for a second and say that it is absolutely clear that there has been a sensational job done at Conrail in improving its financial condition, its performance, and indeed its prospects. That job has been done by a management superbly led by Stanley Crane.

It has been done with the cooperation of labor and, as you commented, at the loss of a number of jobs, but overall with a very, very good cooperation by labor, and also in an environment which was allowed to be or was set up to be, by Congress, with NERSA and other legislation, that basically left the railroad room to maneuver and to operate more as a business in competition with other businesses.

So, it is absolutely clear that there has been a tremendous improvement, and in fact the marketplace has recognized that in the form of the offers that we have now as opposed to what we had before.

When comments are made about Conrail's earnings many times in the press and by others the simple notion has been to just take the bottom line of what Conrail has reported and say that is Conrail's earnings. In a sense, that is a bit misleading, because there are a number of factors which would not exist on an ongoing basis.

Some of those factors are the labor give-ups which at today's level are approximately $120 million per year. At the same time, the nonagreement and management employees have also held their wages below what they most likely would have otherwise been, and that's another sum of money.

The State taxes, which approximate $25 million per year, would have to be paid as soon as the Government no longer owned Conrail. In addition to all that, if a proposal goes forward which basically gives back the Government its NOL's and ITC's, Conrail might be in a taxpaying position so that some money would be going to the Federal Government.

All of those kinds of adjustments would present a very different picture of Conrail's earnings, and of course that picture is certainly well understood by the potential buyers with whom we or the Department of Transportation have had discussions.

With respect to projections now going forward, first of all, Conrail itself has prepared in the recent months a new set of 5-year projections. The management and the board of directors believe those projections to be reasonable ones, although I am sure that you well know and they will admit that projections just are best guesses as to what is going to happen in the future.

The general sense of what they have in their projections is that they believe there is more room for improvement in earnings given a good economy, at the operating level. However, if labor and management nonagreement employees went back to standardized industry wages and, Federal taxes and State taxes had to be paid, then earnings indeed could be lower. In fact, they believe if we came across an economy in which either we had a less buoyant

economy or we had a recession, then in fact earnings could be dramatically lower.

In all cases of the company's projections, they still, however, predict positive cash flows over the next 5-year period.

So it is a very long-winded answer. I am sorry for that. I wanted it to be complete.

Senator LAUTENBERG. The point has been well made. I appreciate it. The next time I will not ask such a long question. Your answer was thorough, and I do appreciate the comments you have made. The fact of the matter is that you cannot use the usual criteria. You cannot talk about multiples of earnings.

I want to make sure that the perception out there is one that is realistic about what it is that we are trying to sell. The mission is not primarily price. The mission is primarily to keep the railroad intact, to ensure that shippers have services available, to remember that the employees contributed a great deal to the well-being of this facility, and to ensure in terms of our analysis of the buyers that there is no leverage buy out here.

This is not the kind of property that we want to take into the capital markets to extract the money with which to pay the Government. We want to make sure as much as possible, and the chairman asked the question, of the conditionality here that says you have to keep this operating as an entity, as the railroad, as the facility that it is.

I do not know how far we can extend that notion, or how far we want to extend it. Legally we can do all kinds of things. All of these ultimately affect the price that the buyer is willing to put into it and the risks it is willing to take on this. I am pleased and surprised, very frankly, and I am sure all of you are, at the number of offers that were generated.

It was not exclusively the skill of your fine organization. The fact is that Conrail is an interesting piece of property.

I was curious about the public marketplace comment. The Conrail entity is by no means ready for public offering in terms of the view of what we are trying to accomplish here. A sale would not be to give a buyer a chance to take it and then go to the public with it. That does not suggest longevity. It does not suggest that we are going to be maintaining a railroad as we should.

I think you agree with that, do you not, that a public offering ought not to be?

Mr. BURNLEY. Let me comment on the nonfinancial aspects of that, and Mr. Brody can talk about the market itself. We certainly have always been of the impression at least that a portion of the equity invested in Conrail by a serious bidder could well be raised in the public market.

Now, we have, on the other hand, had grave concerns that we have yet to find sufficient answers to, in our judgment, about 100 percent public offering. And that would include just the scenario you are talking about where someone comes in, buys control from us and then turns around and does a pure public offering.

Our concerns largely are in the following two categories. Number one, if the Government were to try to do that itself, there is no way you could sell 100 percent of the interest in the common stock in Conrail in one offering. It would have to be staged. You would so

depress the price with any company, dumping all the stock in one fell swoop, you could not do it. So we would run the risk that the Government might make a third of it available and then another third, and then the bottom falls out of the market, and we find ourselves locked in indefinitely as a minority shareholder. That we think would be a terrible outcome of this process.

The second concern has been that because price is not the primary object of this exercise in having a viable railroad back in the private sector as healthy as it is, we do have an obligation to know who is going to end up controlling this railroad in the foreseeable future. There is no way, when you put all of the stock out in the public market, that the Government can control that process. Somebody shows up with a lot of money. They buy control. That happens in this economy from time to time. So we have this consideration before us.

Goldman has been asked by the Secretary to look at a public offering one more time and compare it to these 14 options. We have never ruled out and we certainly do not rule out now any offer that includes raising a portion of the equity to be invested through the public markets, but we will continue to be quite concerned about an offer that raises the risk of control being simply spread out through the market, to give it to whomever it is who has the money and gets there first. And we do feel it very important to make sure that we will know who is going to be running this railroad in the next few years.

Senator LAUTENBERG. I just wanted to check one thing here. CSX has recommended that the Department of Transportation convene a meeting under antitrust immunity to explore the sale of Conrail to the two major eastern railroads. We have discussed time and again the fact that we want this held as a single entity. With this in mind, what is your evaluation of that proposal?

Mr. BURNLEY. Senator, our evaluation of that proposal is that it presents a couple of extremely serious procedural problems, aside from the very serious substantive problem that it presents any time you start talking about breaking this railroad up. And the Secretary's views are well known. She does feel that we ought to sell it as an entity. It has proven, we think, that it can operate successfully and profitably as an entity, and that is, we think, the way that we ought to try to go forward.

The two procedural issues, however, that probably make that notion academic are that; one, the request for a section 401 proceeding under the "4R Act" requires more than one party to participate. We cannot draft another railroad or even a nonrailroad company and make them come forward to sit down at the table with CSX or anybody else to talk about how they might divide up Conrail.

CSX said in its offer that it wished for Norfolk Southern to join it. At this moment at least Norfolk Southern has publicly declined that invitation. So we think that issue has been addressed on that basis alone.

Second, the NERSA statute does say that the Secretary must work toward the sale of Conrail as an entity and can only consider the possibility of selling it in pieces if she comes back to the Congress and says to you that it is not feasible to sell it as an entity.

With 14 offers on the table, obviously we no longer, even if we wished to consider that as an option—and we have not wished to do so—but even if we wished to, we no longer have it as an option because there is no way she can come back and say that it cannot be done.

Senator LAUTENBERG. OK. So it could be a defensive move on CSX's part.

Mr. BURNLEY. They certainly have an interest in the future of Conrail. It is an understandable interest. And I think it is important to point out that they gave us two documents. The first document is the one you have alluded to. The second document says:

> If, in the event it is not possible for us to go forward in discussing with you and Norfolk Southern how we might break Conrail in two, then we will put a bid on the table that equals or exceeds the best bid you get.

We have treated that as a bid, and we have understood it to be a bid that will meet the best other bid we have. And we certainly expect to have further discussions with CSX, among other bidders, about how they would flesh that out.

Senator LAUTENBERG. Last weekend the Conrail Board announced that it reserved the right to criticize, reject or make counteroffers to anything on the table. Is that a proper characterization of what the board said?

Mr. BURNLEY. Senator, we did not understand it quite that way. The language in the resolution seemed designed—and based upon discussions with the leadership of Conrail and its board—we understand it to be designed—to simply be a reassertion of what we think is a very appropriate role for Conrail's board, and that is to be fully consulted in this process.

The Secretary has been in close and frequent touch with the board throughout the past 1½ years since she became Secretary, in any event. And I have often had contacts and Mr. Riley has often had contacts with them. So we certainly understood it as a reaffirmation by the board of the very legitimate role it will play.

Senator LAUTENBERG. It says reject also.

Mr. BURNLEY. Well, sir, I understand that that was drafted on a napkin or a legal pad or something else when they were having a meeting at Union Station. I am not sure that they meant for us to read it quite that literally, and certainly our followup discussions with them have not led us to be concerned that they will announce to the world that the Secretary has made a recommendation to the Congress with which they disagree.

The reason we have a good deal of confidence in that, aside from board members having told us that that is what they really meant, is that, again, we intend for them to be fully consulted, their views to be factored in in a serious way, not just a symbolic way, prior to a recommendation being made by the Secretary.

Senator LAUTENBERG. OK. Mr. Brody, on the issue of projections you should look at ADP's projections, the company I was formerly associated with, to see the history of 10 years—that is not too bad.

Thank you, Mr. Chairman.

Senator DANFORTH. Senator Long.

Senator LONG. No questions at this point, Mr. Chairman.

Senator DANFORTH. Do you have any more?

Senator LAUTENBERG. No thank you. I think the testimony has been very helpful, and I thank you.

I agree with you, Mr. Chairman, about one thing, except I disagree on the number. You said there were 535 Steinbrenners. I think there are only 534 out there. But I would like to help in this decisionmaking process.

I think the chairman made a very important point in your review of the chain of events, and that is, I think we have an obligation, not only a right, to review this, the terms finally or the decision that is made. I would not like to see the Congress playing a part in the making of the first round decision.

Senator LONG. Could I just ask one question that does appear to me, Mr. Chairman?

Let's look at the success of Conrail in moving from a money losing operation into a moneymaking operation, which is now something that everyone would like to buy. I do not blame everyone for being interested in buying it, because it makes money, and I do not blame anyone from shying away from something that loses money. That is common sense.

But most of Conrail's success looks to me as though it has resulted from the cooperation of labor in reducing the costs. Is it not true that about 16 percent of the personnel of that railroad has been separated?

Mr. BURNLEY. Yes, sir, that is correct.

Senator LONG. Now, is it fair to say that you have had about as much cooperation from the workers and the unions as you could anticipate in that type of situation?

Mr. BURNLEY. It has been outstanding, Senator.

Senator LONG. Well, that is what I understand. In other words, those workers have a contract that called for them to be paid a lot more than they are being paid. Did they not make major concessions that reduced costs by foregoing increases that the contract provided?

Mr. BURNLEY. Yes, sir. In fact, it is approximately $120 million a year in concessions under the current contract.

Senator LONG. So that without the cooperation of labor in giving more productivity, getting more done with a smaller number of people, Conrail would not be a profitmaking operation. You would not be able to sell it to anybody right now. You would have to keep it.

Mr. BURNLEY. No question about it.

Senator LONG. Now, that being the case, does that not provide a good, equitable basis to say that no matter what is worked out in this matter, every effort should be made to consider the workers' desire to increase their stock ownership in the railroad. They now have, what, 15 percent?

Mr. BURNLEY. Yes, sir. That is correct.

Senator LONG. And they would like to buy it, but if they cannot buy it, they would like to buy as much as they can. Incidentally, I have been trying to tell them for years—I was telling them back at the time that the railroad first went broke that they ought to buy it, and it took a long time to get that through to them.

Senator LAUTENBERG. They did not want to buy it then.

Senator LONG. They are like everybody else. If it is losing money, why should they buy it. But to me it is obvious that it would be a wonderful deal for the workers if they could do just what they have done: Make the sacrifices that they have made and give the effort and dedication that is required to put this entity on a paying basis. It would be a great asset. That is how some folks get rich, you know, by buying something that is losing money and then turning it around. Do what needs to be done to make the property show a profit.

Now, should we not encourage that type of effort in all industries, railroad in particular?

Mr. BURNLEY. Senator, certainly in the discussions concerning the future of Conrail we have at all times tried to be sensitive to just the sacrifices that you have made reference to that labor has made. There is no question without the cooperation of both the organized employees and the managerial work force in working through Conrail's problems, we would not be here today talking about 14 bidders.

There is also no question that RLEA the Rail Labor Executives Association, really served as a catalyst this time 1 year ago when they put the first offer on the table. Now, we thought at the time that that offer was not sufficient in and of itself for us to be able to go forward and come to terms with them In fact, on Monday, RLEA put a revised offer on the table that substantially improves upon the original offer.

We feel very strongly, and Secretary Dole personally feels very strongly that we must recognize and we must recognize in a tangible way and not just through rhetoric but in how we do a sale, the contribution of all of the employees of Conrail, and we intend to do that. In fact, we have had extensive and continuous, virtually daily discussions through the last ten months with representatives of organized labor, and Conrail's managerial employees as well about the future of the railroad and how the process was working and how they factored in.

The more serious bidders, who had been involved in looking at Conrail through the spring early on, have also had very extensive discussions with both the organized employees and the senior management of Conrail. The bottom line is that there is no question that the employees are going to be a major factor in any sale. There is no question when you just look at the bids, from those whose bids have been months in the making at least, that, without exception those bids contemplate a major equity role for Conrail's employees. And we certainly expect, whatever the final package looks like that the Secretary recommends to the Congress, that that role will be very, very visible.

Senator LONG. I am satisfied and the record proves that employees can be very good shareholders. Employees more than the shareholders—I mean more than the mere investor shareholders—ought to know whether they have good management. They can see right there on the job whether it is being well run, and they can see whether there is featherbedding and so on.

Our experience in employee-owned operations—I am not saying wholly owned by employees, but I mean operations that are owned 25 percent or more by employees—is that those employes come to

have a substantial stake in it, or to be the straw bosses, as you might say. They are working together, and one fellow is loafing on the job and the other fellow says get your hands out of my pockets, you lazy so-and-so. It is costing me money while you are sitting there and not working. And that is just the opposite of how it would tend to be on some of the so-called union jobs.

And when I say union jobs, I am quoting one of my friends in the labor movement. I recall we were trying to get an industry to locate somewhere and trying to get the costs down and get jobs for workers, if we could do it; and he came back in and said this is not going to be a Government job, meaning that the employees were going to really get in there and make it work and get high productivity, which they were not accustomed to doing on a Government job. But this is a Government job where apparently they have done a good job in getting high productivity.

Treasury has given us very good cooperation in moving to encourage employees to be shareholders and to try to achieve the benefits that go with it. You have got two of us sitting here. Senator Danforth and myself are cosponsors of the employee stock ownership provisions that are in that bill in conference right now. The Secretary of Treasury agreed to go along with most of the major features of that measure that we passed through the Senate.

I just hope that in your Department you are going to capitalize on the same incentive. The Chicago and North Western Railroad was bought by workers. Did they not turn that one around?

Mr. BURNLEY. Yes, sir.

Senator LONG. All of a sudden it started making money. Most of the workers would not buy it, would not put any money into it, but those of them who did provided the leadership to make that railroad a profitable railroad. And I would hope that your group over there will look at what has been achieved not only in this employee operation, but in the others.

Now, look at Wierton Steel. A lot of folks said we are throwing good money after bad money. There is no Government money in that. Thank God National Steel, rather than just closing that mill down, was willing to help those people obtain the credit to try to make it on their own. The chief executive officer of National Steel came and asked me if I would do what I could to try to encourage those people, because he said National could not take this burden anymore, and would have to move out of there. But he did not want to just abandon those workers. And where it had been losing money for 3 years, people said there is no hope—it was an old mill, and would have to go. In the first quarter under employee ownership it showed a profit. What did they do? They took a pay cut and laid off a bunch of their own crowd, their own gang, and now they are hiring workers back. But it showed a profit in the first quarter.

So if we can get that spirit instilled in workers. I think it is an element of psychology, and a lot of people just do not recognize it—why does not that guy get out there and produce like I produce: I am a partner in my operation, and that fellow over there is just working for that so-and-so. It is typical of so many operations that the boss is a son of a you-know-what. It is entirely different when a fellow is working for himself. The boss is a partner.

Mr. BURNLEY. Senator, you can see today from Stan Crane down to the most junior engineer on Conrail just the kind of pride that you are referring to, because they do, very justifiably, feel that they have a legitimate stake in the future of Conrail. They have made very substantial sacrifices.

And I had the occasion several months ago to ride in a cab with one of Conrail's trains for a while, and it really is quite remarkable when you talk to the line employee the sense of commitment they have to the railroad. It is just the psychology you are talking about. And that is why Secretary Dole has felt very strongly that if we forget any other aspect of this transaction, we cannot forget the importance of a continuing, important, prominent role in ownership for the employees.

Senator LONG. Another kind of employee—I mean another kind of shareholder that is a very good shareholder is a retired employee. When this fellow retires and has stock in the company, he knows what it is all about. He has been there. He is drawing a pension from the company, and as far as those workers are concerned, he is not one of those so-and-sos. He is a hell of a good guy that did his term when his day was there, and now he is drawing some benefits for the good work he did to make something for them. It is just an entirely different relationship from people feeling that that guy is out there to get rich at their expense. And it is unfortunate that studies show that in most operations in America, the employees feel that if they do a better job they are not going to get the benefit of it. Somebody else gets the benefit of it. Apparently that must not be the feeling of Conrail for it to be doing as it is doing.

Mr. BURNLEY. Just to the contrary, I think.

Senator LONG. Some of these indications are that some of the proposals would give the workers as much as 40 percent of the stock. Do several of those proposals go that high?

Mr. BURNLEY. Yes, sir. I believe there's one that goes to 40 percent, and RLEA, I believe, made that proposal. But all of the proposals contemplate something in the 15 to 40 percent range and probably representation on the Conrail board of one, two or three of labor and nonorganized employee representatives. So we certainly have quite an array of opportunities there, and without getting into the specifics about which one makes more sense than the other, we do think again that labor's role and the managerial team's role in the future of Conrail is critical. And we are going to come out, I am sure, with a proposal to present to the Congress that fully recognizes that role.

Senator LONG. Thank you.

Senator DANFORTH. Thank you very much, gentlemen, for very good testimony. That concludes the hearing.

[Whereupon, at 11:05 a.m., the subcommittee was adjourned, subject to the call of the Chair.]

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